Volume 16 | Number 11 Article 2

6-8-2005

Cases, Regulations, and Statutes

Robert P. Achenbach Jr
Iowa State University

[24] Michigan Pork Producers Association v. Veneman, 348 F.3d 157 (6th Cir. 2003), *aff'g sub nom.,* Michigan Pork Producers, *et al.* v. Campaign for Family Farms, *et al.,* 229 F. Supp. 2d 772 (W.D. Mich. 2002).

[25] Livestock Marketing Association v. United States Department of Agriculture, 207 F. Supp. 2d 992 (D. S.D. 2002).

[26] *See, e.g.,* Rust v. Sullivan, 500 U.S. 173 (1991) (Court upheld government regulations limiting ability of Title X fund recipients to engage in abortion-related activities). While the Court's opinion was issued before Justice Thomas became a member of the Court, it is reasonable to believe he would have sided with the majority in *Rust*.

[27] 10 U.S.C. § 983.

[28] The court, in early 2005, stayed its opinion pending the U.S. Supreme Court agreeing to hear the case. Forum for Academic and Institutional Rights v. Rumsfeld, 390 F.3d 219 (3d Cir. 2004), *rev'g,* 291 F. Supp. 2d 269 (D. N.J. 2003), *cert. granted,* 2005 U.S. LEXIS 3756 (U.S. May 2, 2005).

[29] *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

HORSES. The plaintiff was employed by the defendant as a stable hand and was injured while walking a horse in a barn as part of the plaintiff's duties. The horse stepped on the plaintiff's foot after being spooked by the barking of one of the defendant's dogs. The plaintiff argued that the defendant was negligent in failing to properly restrain the dog. The court held that the defendant did not owe a duty to the plaintiff to restrain the dog because the existence of dogs and their interaction with horses was not an abnormally dangerous condition on a farm. In addition, the court noted that there was no evidence that the dog had any history of barking at the horses while the horses were in the barns. **Rodriguez v. Gauger, 2005 Mich. App. LEXIS 1127 (Mich. Ct. App. 2005)**.

ADVERSE POSSESSION

FENCE. The disputed strip of land was located on the plaintiff's side of a fence but was part of the recorded land of the defendant. Both parties used their land for farming and the evidence demonstrated that the plaintiff used the disputed strip as part of the plaintiff's farming operations, relying on the fence as the boundary line between the properties. The defendant argued, however, that the plaintiff's use of the strip was permissive because the fence was built to accommodate the plaintiff's cattle access to a pond. The defendant also cited use of the disputed strip by the defendant and family for hunting and hiking. The trial court had granted summary judgment to the defendant based on the permissive use of the disputed land and the defendant's use of the land. The appellate court reversed and remanded the case for trial, holding that the plaintiff had raised sufficient evidence to create an issue of fact as to whether the fence existed when the plaintiff's father purchased the land, thus removing the possibility that the fence was built with the permission of the defendant. The court also rejected the claim that the defendant's use of the disputed strip was sufficient to defeat the adverse possession claim, because the defendant's use occurred after title would have passed by adverse possession. **Wadsworth v. Thompson, 2005 Ala. Civ. App. LEXIS 257 (Ala. Ct. App. 2005)**.

The disputed strip of land was located on the defendant's side of a fence but was part of the recorded title for the plaintiff's land. The defendant had leased the plaintiff's land for many years from the previous owners of the plaintiff's property. However, the defendant pointed to the previous owner's use of the defendant's land as including the disputed strip for sufficient time for title to pass by adverse possession. The court held that the defendant could claim title by adverse possession under the previous owner's adverse use of the land up to the fence if the defendant had received title through written conveyances which indicated that the conveyance included the land up to the fence. The court held that the defendant's claim was supported by sufficient evidence to raise an issue of fact to reverse the trial court's summary judgment ruling for the plaintiff. **Moser v. Batchelor, 2005 Tex. App. LEXIS 3702 (Tex. Ct. App. 2005)**.

BANKRUPTCY

GENERAL

EXEMPTIONS

EARNED INCOME TAX CREDIT. The debtor claimed an exemption, under Ala. Code § 38-4-8, for a federal income tax refund which resulted from the earned income tax credit (EITC). The state exemption applied to amounts paid as public assistance. The court held that the EITC qualified as an amount paid as public assistance and allowed the exemption. ***In re* James, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,367 (11th Cir. 2005)**.

FEDERAL TAXATION

DISCHARGE. The debtor had filed a timely return for 1994 but did not pay the tax liability listed on the return. The 1994 tax liability was challenged in court by the debtor but a final judgment for the taxes was issued against the debtor. The debtor filed two bankruptcy cases which were eventually dismissed and attempted to conceal assets from the IRS by placing funds in cashier's checks. The debtor maintained a lavish life-style, purchased several vehicles, failed to reveal assets to the IRS and violated court orders against using funds subject to court orders. The court held that the debtor's activities constitute willful attempts to evade payment of the 1994 taxes; therefore, the 1994 taxes were nondischargeable. ***In re* Lowrance, 2005-1 U.S Tax Cas. (CCH) ¶ 50,369 (Bank. N.D. Okla. 2005)**.

The debtor filed income tax returns for 1981 and 1982 but with crossed out jurats. The court ruled that the altering of the jurats made the returns unverified and not valid returns; therefore, the taxes owed for those years was nondischargeable under Section 523(a)(1)(B)(i). The appellate court affirmed on this point. ***In re* Pelullo, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,359 (E.D. Pa. 2005), *aff'g on point*, 2004-1 U.S. Tax Cas. (CCH) ¶ 50,191 (Bankr. E.D. Pa. 2004).**

FEDERAL AGRICULTURAL PROGRAMS

DISASTER PAYMENTS. The 2004 Dairy Disaster Assistance Payment Program was established to provide up to $10 million in assistance to dairy producers in counties declared disaster areas by the President due to a hurricane in 2004. The CCC has issued proposed regulations implementing the program. **70 Fed. Reg. 30009 (May 25, 2005)**.

FARM LABOR. The National Agricultural Statistics Service has issued farm employment figures as of April 10-16, 2005. There were 978,000 hired workers on the nation's farms and ranches the week of April 10-16, 2005, down 10 percent from a year ago. Of these hired workers, 746,000 workers were hired directly by farm operators. Agricultural service employees on farms and ranches made up the remaining 232,000 workers. All NASS reports are available free of charge on the internet. For access, go to the NASS web site: http:/www.usda.gov/nass/ . **Sp Sy 8 (05-05)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT. The petitioners each owned 50 percent of a produce handler corporation which was held to have violated PACA, 7 U.S.C. § 499b(4), for failing to make full payment promptly for produce. The petitioners were held to be responsibly connected to the produce company because they held the entire ownership interests in the company, were the officers of the corporation, and worked full time in the operation and management of the business of the corporation. **Sudano v. USDA, 2005 U.S. App. LEXIS 8602 (4th Cir. 2005)**.

The defendant was the sole owner of a produce wholesaler which had purchased produce from the plaintiffs but had not paid for the produce. The plaintiff filed PACA trust claims against the defendant and the defendant's company but the company's assets were unreachable because of other litigation. The plaintiffs sought a judgment against the defendant personally for the PACA trust amount and attorney's fees. The produce invoices provided for attorney's fees and litigation costs for recovery of unpaid invoices; therefore, the court held that the PACA trust amount covered the attorney's fees and could be recovered by the plaintiffs from the PACA trust. The court also held that the plaintiffs could proceed against the defendant personally, before attempting to recover from the company's assets, where the company's assets were unreachable and the defendant solely owned the company and controlled the company's operations such that the defendant would be personally liable for the company's liabilities under the PACA trust. **Top Banana, LLC v. Dom's Wholesale & Retail Center, Inc., 2005 U.S. Dist. LEXIS 8976 (S.D. N.Y. 2005)**.

PINE SHOOT BEETLE. The APHIS has issued interim regulations amending the pine shoot beetle regulations by adding counties in Illinois, Indiana, New York, Ohio, Pennsylvania and Wisconsin to the list of specific quarantined areas in which the pine shoot beetle has been located. In addition, the interim regulations designate the states of New Hampshire and Vermont, in their entirety, as quarantined areas based on their decision to no longer enforce intrastate movement restrictions. **70 Fed. Reg. 30329 (May 26, 2005)**.

TUBERCULOSIS. The APHIS has issued interim regulations which amend the regulations concerning tuberculosis in cattle and bison by reducing, from 6 months to 60 days, the period following a whole herd test during which animals may be moved interstate from a modified accredited state or zone or from an accreditation preparatory state or zone without an individual tuberculin test. **70 Fed. Reg. 29579 (May 24, 2005)**.

FEDERAL ESTATE AND GIFT TAXATION

DISCLAIMER. The taxpayer was an heir under a decedent's will. The will provided that any disclaimed portion of the estate would pass to a specific charitable foundation. The taxpayer, the taxpayer's spouse and their four children served as directors and officers of the foundation. The foundation amended its bylaws to provide that any disclaimed funds would be placed in a special fund which was controlled by a committee which could not include the person who disclaimed the funds. Within nine months after the death of the decedent, the taxpayer disclaimed a specified amount of the inheritance and the funds were placed in a special fund by the foundation. The IRS ruled that the disclaimer was qualified under I.R.C. § 2518 and the decedent's estate could claim a charitable deduction for the funds passing to the foundation. **Ltr. Rul. 200519042, Feb. 3, 2005**.

TRUSTS. The decedent had established three trusts for the decedent's heirs which gave the trustee the discretionary power to allocate capital gains between income and principal. The current beneficiaries had a right to only the trust income and the remainderholder of each trust was a charitable foundation. During the tax years involved, the trustee always allocated any capital gains to trust principal and excluded the gains from trust taxable income. The trustee argued that, because capital gains were always allocated to principal and the remainder holder was a charity, the gains were excluded from trust income under I.R.C. § 642(c)(2). The IRS pointed to *Rev. Rul. 1973-95, 1973-1 C.B. 322* which held that a trust was not allowed to exclude gain under I.R.C. § 642(c)(2) where the trustee had discretionary power to allocate gains between income and principal. The ruling stated that the discretionary power would also allow the trustee to allocate gains as income in years when the trust had losses, resulting in a reduction in gains previously available to the charitable remainder holder. The court held that Rev. Rul. 73-95 applied to deny the trust the exclusion of the gain from trust income. The court also held that New Hampshire law did not prevent the trustee from allocating gains to income. **Samuel P. Hunt Trust v. United States, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,357 (D. N.H. 2003)**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The taxpayer was a vertically integrated producer, processor, distributor and marketer of fresh and processed animal products. The taxpayer had valued the livestock inventory on the lower of cost or market method as provided in Treas. Reg. § 1.471-4. The taxpayer filed a Form 3115, Application for Change in Accounting Method, which requested permission to change the inventory valuation to the farm price method under Treas. Reg. § 1.471-6(d). The IRS issued a consent agreement to allow the change and provided that the taxpayer could use a method of valuing animals raised for sale or slaughter that reflects the fact that the value of the animals increases ratably as the animals mature. The taxpayer's method initially assigned a constant value to each animal until the animal reached the earliest age at which the animal could be sold to a meat processor. In a Chief Counsel Advice letter ruling, the IRS ruled that this method was unreasonable on its face and violated the consent agreement because the time period for the constant value was 60 to 80 percent of the animal's life cycle and did not reflect an increase in value over that time. **CCA Ltr. Rul. 200520025, Oct. 22, 2004**.

CASUALTY LOSSES. The taxpayer suffered water damage in the taxpayer's basement from water which backed up the drain as a result of heavy rains. The taxpayer claimed a casualty loss for the value of the damaged personal property by deducting 10 percent for depreciation. The taxpayer did not have written records because the records were destroyed in a fire. The taxpayer thus relied solely on oral testimony to support the claimed valuations and overall deduction. The court noted that the taxpayer made no attempt to support the testimony with itemized written statements or statements by witnesses to the flood. The court upheld the IRS denial of the casualty loss deduction for lack of substantiation. **Darling v. Comm'r, T.C. Memo. 2005-123**.

CONSERVATION EASEMENTS. The taxpayers owned a vacation home on 10 acres of shoreline on Lake Michigan. The taxpayer granted a conservation easement on a portion of the property to a qualified conservation organization and claimed a charitable deduction for the value of the easement (based on the decline in value of the affected property), less the amount of enhancement to the value of the remaining property. The easement restricts development of the lakefront areas as part of an attempt to preserve the natural setting for wild flora and fauna and to maintain the existing shoreline. The easement did not restrict development on the portions of the property not subject to the easement. The IRS argued that the easements did not meet the conservation purposes tests listed in Treas. Reg. § 1.170-14(d)(3). The court held that the taxpayers and the conservation organization demonstrated the various conservation purposes served by the easements, including the protection of habitat for wild flora and fauna and preservation of fragile shoreline property. **Glass v. Comm'r, 124 T.C. No. 16 (2005)**.

CONSTRUCTIVE RECEIPT. The taxpayer had entered into eight Conservation Reserve Program (CRP) contracts which provided for annual payments in exchange for removing the land from production. The annual payments were contingent upon the taxpayer's continued compliance with the contract terms. The taxpayer assigned the right to 90 percent of the payments in exchange for a lump sum payment. The assignment was reported to the USDA. The taxpayer initially included the entire lump sum in gross income in the tax year received but later filed an amended return including only the annual contract payment in gross income and a deduction for the 90 percent which was paid to the assignee. In the following tax years, the taxpayer included the entire annual payment in gross income. In a Chief Counsel Advice letter ruling, the IRS ruled that the lump sum payment was included in gross income when received because the payment was received without restriction on its disposition by the taxpayer. In addition, the IRS ruled that, in the tax years following the assignment, the taxpayer should include in gross income only the 10 percent portion of the annual payments not sold to the assignee. **CCA Ltr. Rul. 200519048, Jan. 27, 2005.**

CORPORATIONS

CONSTRUCTIVE DIVIDENDS. The taxpayers were majority shareholders in a small corporation which produced desserts for grocery stores, restaurants and other food businesses. The corporation had a credit card which was used by the taxpayers to pay for personal travel, clothes, meals and entertainment expenses. The taxpayer did not have records to identify the purposes of the expenses and most were conceded to be personal expenses. The corporation claimed the expenses as a "sales expense" business deduction. The court held that the charged payments were not eligible for a business deduction because the expenses were personal to the taxpayers. In addition, the court held that the payments were constructive dividends to the taxpayers as payment of their personal expenses. **Lenzen v. Comm'r, T.C. Memo. 2005-120**.

COURT AWARDS AND SETTLEMENTS. The taxpayer brought a case under the False Claims Act on behalf of the government and obtained a settlement. The taxpayer received a portion of that settlement as a qui tam relator award for bringing the case. The taxpayer excluded the relator award from income, arguing that the payment was for personal injuries suffered during the case. The court held that the relator award was taxable income because the taxpayer's injuries were not part of the False Claims Act case. **Brooks v. United States, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,353 (6th Cir. 2005), *aff'g*, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,414 (E.D. Ky. 2003)**.

DEPRECIATION. The IRS has adopted as final regulations that replace the use of the Standard Industrial Classification (SIC) with the North American Industry Classification System (NAICS) for use in determining what properties are of a like-class for purposes of I.R.C. § 1031. See Harl, "New Rules on Like-Kind Exchanges with Personal Property," 15 *Agric. L. Dig*. 129 (2004). **70 Fed. Reg. 28818 (May 19, 2005)**.

ELECTRICITY PRODUCTION CREDIT. The IRS has announced the 2005 inflation adjustment factor (1.2528) and reference price used in determining the availability of the renewable electricity production credit to taxpayers producing electricity using wind at 4.85 cents per kilowatt hour. The inflation adjustment factor and reference prices apply to calendar year 2005 sales of kilowatt hours of electricity produced in the U.S. and its possessions from qualified energy resources. The renewable electricity production credit for calendar year 2005 is 1.9 cents per kilowatt hour on the sale of electricity produced from wind, closed-loop biomass, geothermal and solar energy resources and 0.9 cents per kilowatt hour on the sale of electricity produced from open-loop biomass, small irrigation power, landfill gas and trash combustion facilities. **Notice 2005-37, I.R.B. 2005-20**.

JOINT VENTURE. Although the taxpayer and former spouse were divorced at the time, the taxpayer and former spouse filed a joint return for several tax years. The returns included losses on Schedule C forms for a horse breeding operation run by the former spouse on land owned by the taxpayer. The horse operation was funded by money provided by the taxpayer under the divorce agreement. When the IRS denied the taxpayer the use of the joint return, the taxpayer argued that the taxpayer was entitled to a portion of the horse breeding operation losses as a joint venturer. The taxpayer did not provide evidence of any agreement to share profits and losses, to allow the taxpayer to participate in the management of the business, or to contribute to the capital of the business. The court held that the taxpayer was not a joint venturer with the former spouse and was not entitled to deduct any of the losses from the activity. **Corrigan v. Comm'r, T.C. Memo. 2005-119**.

PARTNERSHIPS

CONTRIBUTION OF SERVICES**.** The IRS has issued proposed regulations which provide that the transfer of a partnership interest in connection with the performance of services is subject to I.R.C. § 83 and provide rules for coordinating I.R.C. § 83 with partnership taxation principles. The proposed regulations also provide that no gain or loss is recognized by a partnership on the transfer or vesting of an interest in the transferring partnership in connection with the performance of services for the transferring partnership. **70 Fed. Reg. 29675 (May 24, 2005)**.

LIABILITIES. The IRS has adopted as final regulations regarding a partnership's assumption of a partner's liabilities in a transaction occurring after October 18, 1999, and before June 24, 2003. Under the regulations, if a partnership assumes a liability of a partner (other than a liability to which I.R.C. § 752(a), (b) apply) in a transaction described in I.R.C. § 721(a), then, after application of I.R.C. § 752(a), (b), the partner's basis in the partnership is reduced (but not below the adjusted value of such interest) by the amount (determined as of the date of the exchange) of the liability. For this purpose, the term liability includes any fixed or contingent obligation to make payment, without regard to whether the obligation is otherwise taken into account for federal tax purposes. The adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under Treas. Reg. §§ 1.752-1 through 1.752-5. The exceptions under I.R.C. § 358(h) applicable to corporate assumptions of shareholder liabilities generally apply for purposes of the regulations. Therefore, a reduction in a partner's basis generally is not required, under these regulations, after an assumption of a liability by a partnership from that partner if: (1) the trade or business with which the liability is associated is transferred to the partnership assuming the liability as part of the transaction, or (2) substantially all of the assets with which the liability is associated are contributed to the partnership assuming the liability. However, in the case of a partnership transaction that is substantially similar to the transactions described in Notice 2000-44, the exception for contributions of "substantially all of the assets with which the liability is associated'' does not apply. **70 Fed. Reg. 30334 (May 26, 2004)**.

PENSION PLANS. The taxpayer had received an early lump sum distribution from an I.R.C. § 401(k) pension plan and reported the distribution as income; however, the taxpayer claimed an educational expense exclusion from the 10 percent early withdrawal penalty. The court held that the education expense exclusion did not apply to early withdrawals from 401(k) plans but only applied to early withdrawals from IRAs. **Uscinski v. Comm'r, T.C. Memo. 2005-124**.

Agricultural Law Press
P.O. Box 50703 Eugene, OR 97405

SAFE HARBOR INTEREST RATES

June 2005

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	3.46	3.43	3.42	3.41
110 percent AFR	3.81	3.77	3.75	3.74
120 percent AFR	4.16	4.12	4.10	4.09
Mid-term				
AFR	4.01	3.97	3.95	3.94
110 percent AFR	4.42	4.37	4.35	4.33
120 percent AFR	4.82	4.76	4.73	4.71
Long-term				
AFR	4.57	4.52	4.49	4.48
110 percent AFR	5.03	4.97	4.94	4.92
120 percent AFR	5.49	5.42	5.38	5.36

Rev. Rul. 2005-32, I.R.B. 2005-23.

S CORPORATIONS

ELECTION. The IRS has adopted as final regulations which provide that, if an eligible entity makes a timely and valid election to be an S corporation under I.R.C. § 1362(a)(1), it is treated as having made an election to be classified as an association under Treas. Reg. § 301.7701-3. However, if the eligible entity's election is not timely and valid, the default classification rules provided in Treas. Reg. § 301.7701-3(b) will apply to the entity unless the IRS provides late S corporation election relief or inadvertent invalid election relief. If the late or invalid election is not perfected, the default rules will maintain the passthrough taxation treatment by classifying the entity as a partnership or a disregarded entity. **70 Fed. Reg. 29452 (May 23, 2005)**.

SHAREHOLDER BASIS. The taxpayer claimed a portion of net operating loss from an S corporation based upon the taxpayer's ownership of 836,540 shares of stock transferred under an action by the board of directors. However, the taxpayer did not provide any evidence to support the taxpayer's basis in the stock and the court held that the passthrough of the loss deduction would not be allowed. **Chu v. Comm'r, T.C. Memo. 2005-110**.

TAX PROTESTERS. After attending a seminar sponsored by the American Institute for the Republic, the taxpayers, husband and wife, stopped filing federal income tax returns. Although the taxpayers made some minimal payments of taxes, the taxpayers primarily made only filings of letters filled with tax protester arguments against the legality of the tax system. The taxpayers did not maintain records for their businesses and transferred most of their personal assets to a family limited partnership. The court held that the taxpayers were liable for additions to tax for fraudulent failure to file timely income tax returns, could not claim business deductions for items without substantiation and were liable for penalties for failure to pay estimated taxes. **Runkle v. Comm'r, T.C. Memo. 2005-112**.

TRAVEL EXPENSES. The IRS has issued guidance on the limitation under I.R.C. § 274(e) on the deductible amount of trade or business expenses for use of a business aircraft for entertainment. Section 274(e) was amended by the American Jobs Creation Act of 2004 to limit the exceptions in I.R.C. § 274(e)(2) and (9) to specified individual to the extent that the expenses do not exceed the amount of expenses that are treated as compensation to the specified individual. A specified individual is any individual who is subject to the requirements of Section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(a)) with respect to the taxpayer, or who would be subject to those requirements if the taxpayer were an issuer of equity securities referred to in that section. See I.R.C. § 274(e)(2)(B). This notice is available at http://www.irs.gov/pub/irs-drop/n-05-45.pdf **Notice 2005-45, I.R.B. 2005-24**.

TRUSTS. The taxpayer had created a sham trust and filed a Form 1041 claiming a refund for taxes paid but which were not actually paid by the trust. The IRS paid the refund and the taxpayer cashed the check. The IRS sought recovery of the refund plus interest. The court held that the IRS could recover the refund plus interest because the trust was clearly a sham. **Farmer v. United States, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,361 (E.D. N.C. 2005)**.